

China a High-stakes Player

What's the Right Move for Indiana Companies?

More and more, China holds the winning hand in the global marketplace. Low labor costs, state-of-the-art technology and a low-valued currency have given the Asian Goliath powerful playing cards.

American automotive giants, television manufacturers, furniture makers and textile leaders are among those who have flocked to China to set up shop; a move made to survive a tight economy and better compete in the burgeoning world market. Some of these companies have relocated part of their operations to China, while others have moved it all – with no intention of returning home.

While the trend of manufacturing products outside the U.S. to achieve lower costs is nothing new – Japan was the hot spot in the 1980s, followed by Mexico a decade later – China is a much stronger opponent in a whole new game.

With ingenuity and know-how often rivaling that of the United States, coupled with a population of over 1 billion – of which a staggering number are looking for work – China poses a formidable and complex challenge.

What's more, on top of the hundreds of thousands of U.S. jobs lost to China, reciprocity in the trade arena is sorely lacking. The U.S. trade deficit with China has reached overwhelming heights, topping \$120 billion in 2003.

Categorically, the United States must counter China's growing impact on the world economy. Making the right move involves both understanding China's ascension and recognizing where opportunities exist to best utilize U.S. strengths.

Discussing the China dilemma and what options are available to Indiana companies are:

Participants

Mark Cooper – director of the Indiana Export Assistance Center, U.S. Department of Commerce, Carmel

Orie Fritts – president of Tradespan International, Columbus

Ted Gary – president of AMG Engineering & Machinery, Inc., Indianapolis

Bill Klem – manager in Othmar Klem Furniture Co., Saint Anthony

Feeling the crush

China's diverse manufacturing capabilities cast a large net, affecting many U.S. industries. In recent years, one that has increasingly taken a hit is the hardwood furniture business, which is Indiana's sixth largest industry.

"It has been ripped up one side and down the other, primarily by the admission of China into the WTO (World Trade Organization)," Klem declares. "It's just a massacre in North Carolina, for example, with one furniture plant after another shutting their doors."

Klem, who has been working in his family-owned wood furniture manufacturing company since 1972, says he's never witnessed such a dramatic shift in his business as has occurred the last few years (since 1999). "The difference is like night and day in regard to what's happening in the marketplace. It's like a tidal wave right now."

According to the U.S. Department of Commerce, China's imports of furniture and parts jumped from \$145 million in 1990 to a staggering \$5 billion in 2001, giving China 27% of the global market.

Othmar Klem Furniture specializes in making contract furniture, such as guestroom furnishings for hotels. At the company's highest point, more than 100 people worked there. Today, the number stands at about 50. "Business is just extremely tough," Klem acknowledges.

At the end of the day, the reason that U.S. furniture makers (as well as other manufacturers)

China, after finishing ninth on the list of importers of Hoosier products in November 2003, dropped out of the top 10 in January 2004.

By Rebecca Patrick

are struggling to be competitive with China is the low labor cost there.

"In the furniture industry, you're basically dealing with costs that are 30% to 35% less in China, and most of that is in labor. And, the furniture industry is a very labor-intensive market," Fritts explains.

"With the cost difference of comparing apples to apples in that area being so significant, it's not hard to see why people went over there in the first place and got it going."

That rationale resonates loudly with Gary, too.

"We manufacture components for automotive-related applications. I know we're going to be forced to look at the things that drive our business from a labor perspective. So, that's where China would be helpful for us," he admits.

"China's impact on pricing is forcing us to consider them as a viable option for some things that we have to supply to our customers on a daily basis."

With all signs pointing to the cheapest labor market as a crucial deciding factor, it puts the U.S. companies at a severe disadvantage, Klem says.

"We've got all kinds of major problems here, including: trade deficits, federal deficits, state government deficits, local government deficits, etc.," he notes. "Not to mention where are our people going to find jobs when we export our jobs continuously?"

New jobs and retraining displaced workers are at the emotional core of the issue. "Retrain them for what? I don't know," Fritts confesses. "Those jobs, like the ones lost in North Carolina (in the furniture industry) will never come back to this country. If they're not going to China, it will be to Vietnam or elsewhere. Those jobs are not returning here."

Free trade and the economy

Ask any given group of manufacturers what has led to their decline/predicament and, chances are, a common reply – rightly or wrongly – will be free trade.

"The furniture industry, the textile industry and others are getting killed. Unrestricted free trade is not good. It's certainly not good for me," Gary asserts.

He notes that, when NAFTA (the North American Free Trade Agreement) became effective, people were really concerned about what was going to happen in Mexico, but it turned out not to be too bad. The trouble is, now the jobs that were in Mexico – and others – are going to China.

"There needs to be some constraints in place to restrict the amount that we're buying from China, because long term, I can see that our entire economy could be seriously impacted," Gary declares.

Cooper argues that free trade is positive, and NAFTA was good for America and U.S. jobs. "The global economy is not

static; it moves around and is in flux all the time. Therefore, labor and industries have to be flexible, and they have to be innovative," he states.

Fritts, whose company does personal consulting with

companies who want to do business in China, also doesn't think trade barriers are the solution.

"If tomorrow, you put up these walls, companies like Kimball (Electronics Group) in Jasper, Miller Veneer in Indianapolis and Robus (Leather Corp.) in Madison are

all going to be severely hurt because they are not going to then sell their hardwood materials to China, plus many of the lost jobs simply won't return no matter what," Fritts explains. "We need to realize that there are winners and losers in every game and go from there."

Instead, Fritts would like to see the U.S. and Indiana "get aggressive about globalization."

A clear proponent of free trade, Fritts does acknowledge that there are some abnormalities and problems with the system, in respect to China, which must be remedied.

"Government involvement in procurement needs to be straightened out. China, for instance, puts a lot of pressure on their companies and their buyers. Also, I believe the valuation of the yuan (China's currency) is one thing that the U.S. government should be hammering on," he stresses.

U.S. manufacturers contend that China is deliberately

undervaluing its currency – by as much as 40% – resulting in a trade advantage when competing with U.S. companies and contributing to the loss of domestic factory jobs.

Another area, perhaps the one the

American government needs to move to the top of its list, says Fritts, is "pressuring China to buy more from the United States and to help the trade deficits associated with that."

The trade imbalance is also a major bone of contention for Klem. "The Chinese don't want anything from the United States except raw material or high-tech type of items that they can put into production to sell goods back to us."

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– Ted Gary
AMG Engineering & Machinery, Inc



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Tradespan International

At \$16.4 billion, Indiana ranked 16th in the nation in total annual exports for 2003.

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Othmar Klem Furniture Co.



Indeed, for all the ships that come to the United States, importing products made or assembled in China, most go back empty. The U.S.' politically sensitive trade deficit with China is its largest by country and has exploded over the least seven years. In 1996, the trade deficit with China stood at \$39 billion. It topped \$103 billion in 2002. Last year, that gap swelled to \$124 billion, an all-time high.

Yet, can China's emergence on the world economic scene shoulder the sole blame for the demise of U.S. manufacturing?

"We spend a lot of time griping about the Chinese imports, but it's coinciding with a time of a down economy," Fritts offers.

A bright spot, Fritts believes, is that "the global economy right now is on a swing back up. We're anticipating the global economy to grow three or 4% next year. If that happens, then Americans are going to get their share of sales, but it may not be in the high labor areas or labor-intensive areas."

Advice and assistance

According to Cooper, to make greater inroads into the world market, having a dynamic economy is vital for the United States.

"We can't do things just like we did in the '50s. Workers have to be willing to adapt, change and modify. There are winners and losers," he says. "That's why we are seeing the push in Indiana right now for us to be a biotechnology and an advanced-manufacturing hub."

"There are industries that Indiana and the United States have to capitalize on as we move up the economic food chain and train our workers to become more adaptable and flexible," Cooper describes.

For the third quarter of 2003, Indiana's exports totaled \$3.8 billion, an increase in exports of 5.5% over the same period in 2002.

For starters, Indiana companies need to see that their market is not just Indiana or the Midwest, he urges.

"I'm a Hoosier, born and raised here. I know how conservative Indiana businesses can be, but we have to look abroad, we have to look overseas, we have to be innovative and flexible," contends Cooper, who says this philosophy rings true for small business as well as large multi-national companies.

"We want to make sure we dispel the myth that only big business can do international trade. We have to be careful that small businesses don't think, 'Oh, China or anywhere else is too much for us,'" he remarks.

More specifically, the notion that a company has to have at least a million dollars on hand to successfully conduct international trade or set up a joint venture is completely inaccurate.

"It's a fraction of that cost. It's really a mind-set more than resources, in my opinion," Fritts contends. "There are lots of ways to do joint ventures or do your own thing in China to take advantage of that market. For instance, I sit on the Indiana District Export Council. We give free service, free supply and are always happy to assist."

Fritts says the key is to not view China as a short-term prospect, but rather as a long-term investment. "As far as the market is concerned over there, I'm sure we're just scratching the surface."

China's billion-plus population is only just beginning to develop enough money to buy cars. The next thing is going to be houses and then furniture, predicts Fritts.

"Five years from now, I think we're going to see huge sales of furniture in China," he maintains.

"They like our American-designed furniture, so it wouldn't surprise me to see it versus the Chinese's own. The furniture may be made in China, but it will be made by American companies."

For those, like Klem, in the contract furniture business or contractors to the hospitality industry, Fritts urges them to seriously consider going into China – right away.

"Between now and 2008, China must build 360 major hotels for the Summer Olympics in Beijing. These are the

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– Mark Cooper
U.S. Department of Commerce



Hyatts, the Westins, the Sheratons and the Shangri-La's. These hotels are all looking for western-style furniture," Fritts describes. "Plus, Indiana has a quality advantage. Hoosier hardwoods, such as cherry, oak and walnut, are considered some of the best in the world."

The role of the federal government and the U.S. Department of Commerce in this picture is to assist Indiana businesses in exploiting these opportunities.

"The specific mission of the Indiana Export Assistance Center is to help Indiana businesses, especially small- to medium-sized companies, compete and win in the global marketplace," Cooper explains. "Specifically, my office is here to make sure that Indiana businesses have opportunities and take advantage of them throughout the world. Also, to ensure that Indiana business interests are taken care of and respected globally, so there is a fair and level playing field for all industries."

Additionally, the Indiana Export Assistance Center is working with the Business Modernization Task Force, a local group, which helps companies learn how to work more efficiently and more productively. The commerce department also has the Trade Adjustment Assistance Program, which helps companies that have been adversely affected by imports. These companies can qualify for up to \$50,000 in matching funds.

"My office doesn't want to be the best-kept secret in government," Cooper insists. We're here in Indiana, in the trenches, working with Hoosier businesses to compete and

win globally."

In southwestern Indiana, the local chambers of commerce and economic development leaders have also stepped up, looking at this dilemma from a number of perspectives, praises Klem.

"I think this is very positive and encouraging. For example, we are establishing a manufacturing alliance with the help of the BMT (the Indiana Business Modernization and Technology Corporation) out of Indianapolis," he notes.

"I'm really excited and happy to see, in my part of the state, groups coming forward, trying to do whatever it takes to save manufacturing jobs in Indiana."

This resolute spirit is exactly what's needed and will push Indiana forward, Fritts believes. "Bottom line is nobody likes a crybaby. Everybody likes a winner. We've got to find a way to win the fight, not cry about it," he declares. "It's time to wage that battle."

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